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In the Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-781

FRITZ SCHERK,

Petitioner,

vs.

ALBERTO-CULVER COMPANY,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

REPLY BRIEF FOR PETITIONER

ARGUMENT

I. THE TRANSACTIONS AT ISSUE ARE INDISPUTABLY INTERNATIONAL IN CHARACTER.

Respondent Alberto-Culver Company contends that this is no more than a garden variety domestic dispute. Alberto-Culver achieves the aura of domesticity in its Statement Of The Case only by severely truncating the facts and focusing on a few Illinois contacts. There is no reason

why this Court must ignore the *undisputed* facts contained in the affidavits submitted by the Petitioner.

The undisputed facts in the record clearly demonstrate that these transactions are international, not domestic. The businesses acquired were European businesses, manufacturing and selling goods in Europe and licensing trademarks in countries other than the United States. (A. 3-4, 32-33, 48-49.) The negotiations began in Europe, proceeded for two years on both sides of the Atlantic and finally concluded at a closing held in Geneva, Switzerland in June, 1969. (A. 30-31, 86-89.) During the course of the negotiations, numerous meetings took place in Europe, as did a detailed investigation of the businesses. Once the preliminary terms were agreed upon in the spring of 1968, a full year elapsed before the closing. During that time, the parties negotiated and finally agreed upon extensive, written contracts, including 25 pages of detailed trademark warranties.* The acquisition agreements did not become binding upon Mr. Scherk until he signed them in Europe. Thus, Alberto-Culver's characterization of these transactions as essentially domestic is clearly erroneous.

II. THE TRANSACTIONS AT ISSUE ARE STANDARD BUSINESS ACQUISITIONS.

When Alberto-Culver asserts that these transactions are typical securities transactions and that it is just an ordinary investor in need of the protections afforded by the Securities Exchange Act of 1934 (the "Exchange Act"), it is putting form over substance.

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* The trademark warranties in the FLS contract run for eleven pages, and in the SEV contract for fourteen pages. (Exhibits 1 and 3 to Complaint, Record Document No. 2.)

Any fair appraisal of the *substance* of these transactions produces the conclusion that Alberto-Culver wanted to buy, and did buy, operating businesses that manufactured and sold cosmetics. Alberto-Culver was not looking for an investment vehicle. It wanted to conduct business operations in Europe, and the acquisition of the Scherk businesses was to provide the means to that end.

Once the dispute arose between the parties, Alberto-Culver fell back on the form of the transactions, pleading a Rule 10b-5 claim, at least in part, certainly, hoping to escape its obligation to arbitrate. Cutting through the ubiquitous 10b-5 label, the gist of Alberto-Culver's claim is alleged breach of contractual warranties and common law fraud. The Second Circuit has recently expressed concern that the ease with which one can state a Rule 10b-5 claim unfairly allows plaintiffs to "[strip] the defendant of its contractual right to arbitrate." *Kavit* v. *A. L. Stamm*, [Current Binder] CCH Fed. Sec. L. Rep. ¶94,365 at 95,235 (2d Cir. 1974).

III. ALBERTO-CULVER'S EXCUSES FOR SEEKING AN ESCAPE FROM ITS AGREEMENT TO ARBITRATE ARE NOT COMPELLING.

Alberto-Culver asserts that *Wilko* v. *Swan*, 346 U.S. 427 (1953), applies to this case and precludes arbitration. The central issue, however, is whether or not *Wilko* should be applied to international transactions such as the ones present in this case. If *Wilko* does not apply in the context of this case, the arbitration provisions are enforceable.

Wilko was a domestic case decided twenty years ago without any consideration given to its effect on, or

the exigencies of, international commerce.* Since that time, there has emerged a strong, national public policy in favor of enforcing international arbitration agreements. *First*: this country acceded to the United Nations Convention On The Recognition And Enforcement Of Foreign Arbitral Awards (the "UN Convention"), with Congress enacting Chapter 2 of the Federal Arbitration Act, 9 U.S.C. §201 *et seq.*, to implement that accession.** *Second*: the United States signed the U.S.-U.S.S.R. Trade Agreement of 1972, which states that both governments encourage the use of arbitration to settle disputes arising out of international commercial transactions between their citizens. 67 Dept. State Bull. 595, 597 (1972). *Third*: this Court in *M/S Bremen* v. *Zapata Off-Shore Co.*, 407 U.S. 1 (1972), recognized that forum selection clauses are indispensable elements in international commercial transactions. 407 U.S. at 13-14. Arbitration agreements are merely one type of forum selection clause.

The *Wilko* rationale as applied to the Exchange Act rests on Section 29(a) of the Act, 15 U.S.C. §78cc(a), which

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* Respondent cites various cases where *Wilko* has been applied to disputes under the federal securities laws. Br., p. 18 n 8 and p. 25 n 15. None of those cases is determinative of the issue before this Court because none of those cases involved an *international* commercial dispute. They, like *Wilko*, were all decided in a domestic context.

Respondent's reliance on *Alexander* v. *Gardner-Denver Co.*, ___ U.S. ....., 94 S.Ct. 1011 (1974), is also misplaced. That case was concerned with the application of Title VII of the Civil Rights Act of 1964, 47 U.S.C. §2000e *et seq.*, in a case involving a claim of racial discrimination, a pervasive domestic problem. That case has no bearing on international commercial transactions and the policies applicable thereto.

** In so doing, Congress did not exclude transactions involving securities, although that would have been simple to do.

provides that a stipulation or provision waiving compliance with any provision of the Act is void. Alberto-Culver first suggests that it will be deprived of the protection of Section 10(b) and Rule 10b-5. But Mr. Scherk has not asserted that Alberto-Culver will be unable to raise Rule 10b-5 before the arbitrators and seek resolution of that claim. Alberto-Culver next asserts the extraordinary proposition (Br. p. 20) that our securities laws' concepts are so "unique" that the arbitrators could not understand them.* However, the gist of Alberto-Culver's Rule 10b-5 case is:

1. Did Mr. Scherk lie to Alberto-Culver about his trademarks?
2. If so, was the lie about a material fact (*i.e.*, a fact which a reasonable man would or might want to know concerning an investment decision)?
3. If so, was Alberto-Culver deceived by the lie?

That analysis is certainly not beyond the ken of competent arbitrators.

Alberto-Culver suggests that the arbitration provisions result in a waiver of Section 27 of the Exchange Act, 15 U.S.C. §78aa, providing that the United States District Courts have "exclusive jurisdiction" of violations of the Act. The fair interpretation of Section 27 is that, for proceedings brought in a court, the United States District Courts have jurisdiction of Exchange Act violations and the state courts do not. After all, the Securities and Exchange Commission conducts proceedings and disciplines

* The assertion, that our securities laws involve such "unique principles" that foreigners cannot be expected to understand them, if true, should be sufficient grounds for dismissing the action against Mr. Scherk, a foreigner.

broker-dealers and their agents for violations of the Exchange Act.* Disputes between broker-dealers who are members of a stock exchange are arbitrated.** Furthermore, the courts uniformly have concluded that parties can agree to arbitrate *existing* disputes. *E.g., Moran* v. *Paine, Webber, Jackson & Curtis,* 422 Pa. 66, 220 A.2d 624 (1966), and 389 F.2d 242 (3d Cir. 1968); *Reader* v. *Hirsch & Co.,* 197 F. Supp. 111, 117 (S.D.N.Y. 1961) (dictum).

Since *Wilko,* as applied, invalidates only agreements to arbitrate future disputes and not agreements respecting existing disputes, the result must turn on the policy considerations relevant to agreements to arbitrate *in advance* of a dispute. In *Wilko,* the Court faced the situation of brokerage houses using non-negotiated, form contracts requiring customers to waive court suits. The Court also recognized that usually a customer is at a serious disadvantage in dealing with the broker-dealer. The customer

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* *E.g., Coenen* v. *R. W. Pressprich & Co.,* 453 F.2d 1209 (2d Cir. 1972), *cert. denied,* 406 U.S. 949 (1972); *Axelrod & Co.* v. *Kordich, Victor & Neufeld,* 451 F.2d 838 (2d Cir. 1971). This result is based upon interpretation of Section 28(b) of the Exchange Act, 15 U.S.C. §78bb(b).

Based upon an interpretation of 15 U.S.C. §78o-3(b), a customer was able to force a broker-dealer to arbitration against its will because the broker-dealer was a member of the National Association of Securities Dealers, whose rules provide for arbitration. *Financial House, Inc.* v. *Otten,* 369 F.Supp 105 (E.D. Mich. 1973).

** *E.g., Baron & Co., Inc.,* [Current Binder] CCH Fed. Sec. L. Rep. ¶79,609 (Exchange Act Release No. 10480, 1973). The statutory basis for such SEC proceedings is Section 19(a) of the Exchange Act, 15 U.S.C. §78s(a). Such proceedings are not precluded by the "exclusive jurisdiction" language of Section 27. *Wright* v. *Securities and Exchange Commission,* 112 F.2d 89, 95 (2d Cir. 1940).

might well not appreciate what he is giving up. Furthermore, broker-dealers have not refused to engage in their regular business of selling securities because arbitration could not be agreed upon in advance.

However, the exigencies relating to international commercial dealings, particularly of the type involved in this case, are just the opposite. This was an arm's-length, detailed, negotiated business deal between sophisticated businessmen with equal bargaining power, who knew what they were doing. As this Court stated in *Zapata,* the certainty engendered by the obtention of a mutually acceptable, possibly neutral forum for future disputes "is an indispensable element of international trade, commerce, and *contracting.*" (Emphasis added.) 407 U.S. at 13-14. It is this absolute need for certainty in international transactions, without which any specific transaction could be frustrated, that clearly demarcates the instant case from the domestic situation in *Wilko.* In *Wilko,* it did not make sense to preclude arbitration of existing disputes, and it did serve public policy to prohibit agreements to arbitrate future disputes. But in the instant case, it makes no sense to prohibit either agreements to arbitrate existing disputes or future disputes. A rule that Americans engaged in negotiated, international commercial dealings which involve securities cannot agree in advance to arbitration is bound to hinder American international commerce.

None of Alberto-Culver's other reasons for prohibiting arbitration is compelling. First, it asserts that, because other countries make exceptions to their willingness to enforce arbitration agreements, so should the United

States.* That is exactly the type of parochial attitude condemned by this Court in *Zapata*. Admittedly, the UN Convention provides for some exceptions due to public policies of the participating countries. However, exceptions should be just that—exceptions, not the rule. If every country busily excludes major areas from coverage by the UN Convention, the Convention will become illusory and a trap for the unwary.

Alberto-Culver also claims it will be precluded from discovery if it arbitrates. To the extent that is true, Alberto-Culver knew that when it agreed to arbitrate. Moreover, as the Pattishall opinion letter and the Silver affidavit make clear, Alberto-Culver has already investigated its claims and collected the documents which it deems relevant to its claim. (A. 21-27, 40-41.) Since Alberto-Culver has all of the businesses' books and records, it will be at no disadvantage.

Finally, the UN Convention is not being improperly applied in a retroactive manner to Alberto-Culver's contracts. The Convention does not alter the explicit terms of the agreements. It just provides further support for the proposition that those provisions are enforceable.**

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* Based upon the Evans and Ellis law review article, 8 Tex. Int. L. J. 17 (1973), Alberto-Culver asserts (Br. p. 22 n. 11) that in Germany cartel agreements are not arbitrable. But Evans and Ellis specifically state that cartel agreements *involving foreign commerce are arbitrable*, as long as the arbitration clause is authorized by the cartel authorities. 8 Tex. Int. L. J. 17, 41-42 (1973).

** The only basis upon which Alberto-Culver can assert that the UN Convention and Chapter 2 of the Federal Arbitration Act are tampering with its contractual commitments is that when Alberto-Culver signed the agreements, it knew that *Wilko* made these agreements unenforceable. If that is the case, then Alberto-Culver, by not informing Mr. Scherk of that fact, defrauded him. This Court should not sanction that type of conduct.

Unless this Court decides to expand *Wilko* to international commercial transactions, the original Federal Arbitration Act, 9 U.S.C. Ch. 1, compels enforcement of the contracts.

CONCLUSION

Petitioner submits that Alberto-Culver has demonstrated no compelling reason to relieve it of its agreement to arbitrate. Alberto-Culver's position in this case is unenlightened and parochial. It asks this Court to adopt exactly the isolationist policy it condemned in *Zapata*. For its own immediate self-interest, Alberto-Culver urges a policy which is contrary to long-range American business interests.

Alberto-Culver strives to create the impression that enforcement of this arbitration provision will somehow leave it remedyless and will let some malefactor go scott free. While the Petitioner is confident that he will be vindicated in whatever forum this case is heard, Petitioner has never urged that he is free to perpetrate a fraud. He has never said that Alberto-Culver cannot pursue its claim against him. He does, however, assert that the only forum to hear the dispute is the International Chamber of Commerce in Paris.

Furthermore, it is incongruous that Alberto-Culver can hold Mr. Scherk to all of the warranties in the FLS and SEV contracts and at the same time refuse to comply with the arbitration commitments contained in those very agree-

ments. Alberto-Culver should not be allowed to renege on its obligations.

Dated: April 15, 1974.

Respectfully submitted,

ROBERT F. HANLEY
LYNNE E. McNOWN
One IBM Plaza
Chicago, Illinois 60611
Attorneys for Petitioner,
Fritz Scherk

Of Counsel,
JENNER & BLOCK